

## Internal Revenue Service

Number: **201716002**

Release Date: 4/21/2017

Index Number: 355.00-00, 368.14-00,  
481.00-00, 856.00-00

Department of the Treasury

Washington, DC 20224

Third Party Communication: None

Date of Communication: Not Applicable

Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:CORP:02

PLR-110348-15

Date:

January 05, 2017

## LEGEND

Parent =

Distributing =

Distributing 2 =

Sub 1 =

Sub 2 =

Sub 3 =

Sub 4 =

LLC 1 =

LLC 2 =

LLC 3 =

LLC 4 =

LLC 5 =

LLC 6 =

Creditor Group 1 =

Creditor Group 2 =

Creditor Group 3 =

Backstop Parties =

Controlled =

Controlled Sub =

LP =

Corporation X =

Controlled 2 =

Distributing LLC =

State A =

State B =

Business A =

Business A1 =

Business B =

Business B1 =

Month 1 =

Month 2 =

Year 1 =

Year 2 =

Date 1 =

Date 2 =

Bankruptcy Court =

Product =

Structure A =

Structure B =

Retained Assets =

a =

b =

c =

d =

e =

f =

g =

h =

i =

j =

k =

l =

m =

n =

o =

p =

Dear :

This letter responds to your authorized representatives' letter dated March 19, 2015, requesting rulings on certain federal income tax consequences of a proposed transaction (the "Proposed Transaction"). The material information provided in that request and in subsequent correspondence is summarized below.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a "penalties of perjury" statement executed by an appropriate party. This office has not verified any of the materials submitted in support of the request for rulings. Such materials are subject to verification on examination.

This letter is issued pursuant to section 6.03 of Rev. Proc. 2015-1, 2015-1 I.R.B. 1 and section 3.01(48) of Rev. Proc. 2015-3, 2015-1 I.R.B. 129, regarding rulings on one or more significant issues that are presented in a transaction described in section 332, section 351, section 355, section 368, or section 1036 of the Internal Revenue Code (the "Code") or that address the tax consequences that result from the qualification of a transaction under these sections. The rulings contained in this letter only address discrete legal issues presented by the Proposed Transaction. This Office expresses no opinion as to the overall tax consequences of the Proposed Transaction. Except as expressly provided in the Rulings section herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

## FACTS

Parent, a publicly traded State A corporation, is the parent of both an international group of corporations and an affiliated group of corporations that file a U.S. consolidated federal income tax return. Parent and its subsidiaries are engaged in Business A. In Month 1, Year 2, certain of Parent's U.S. subsidiaries, including Distributing, filed for bankruptcy under Chapter 11 of the United States Bankruptcy Code with the Bankruptcy Court (the "Bankruptcy Proceeding"). Parent, which is solvent, did not file for bankruptcy. The Proposed Transaction described below is designed as part of a bankruptcy plan (the "Plan") to allow Distributing to restructure its business.

Parent directly owns a percent of the outstanding shares of Distributing (the remainder is owned by employees and unrelated investors), which is a member of Parent's consolidated group. Through subsidiaries, disregarded entities, and pass-through entities, Distributing is engaged in both Business A and Business B.

Distributing wholly and directly owns (among other subsidiaries) Sub 1, Distributing 2, Sub 2, and Sub 3. Sub 1 has several direct subsidiaries, including Sub 4, which is the b percent partner in LLC 1 (Distributing owns the remainder). Distributing 2, Sub 2, Sub 3, and LLC 1 are referred to herein as the "Business B Entities".

Distributing also directly owns a c percent interest in LLC 2, an entity treated as a partnership that was formed in Year 1 to provide services to Parent's operations. Distributing indirectly owns most of LLC 2's remaining interests. In Month 2, Year 1, certain Business B employees became employees of LLC 2.

Generally, Distributing has used Business B to provide Product free or at a reduced price to customers under its customer loyalty program, although other customers also may purchase Product for a fee. At present, Distributing does not compensate the Business B Entities for the full value of Product provided to customers under the customer loyalty program; thus, Business B has been operating at a loss. After the Proposed Transaction, Business B is expected to provide Product to Distributing on arm's-length terms.

Distributing currently owes almost \$d to Creditor Group 1, Creditor Group 2, and Creditor Group 3 (collectively, the "Creditors"). The amount of Distributing's debt exceeds the total fair market value of its assets.

### PROPOSED TRANSACTION

Pursuant to the Plan, all Creditors' claims against Distributing and its subsidiaries will be cancelled in exchange for the right to receive stock, cash, debt, and other consideration. The Proposed Transaction steps are as follows:

#### *Completed Transaction Steps*

- (i) On Date 1, Sub 1 converted from a corporation to a limited liability company under state law.
- (ii) On Date 2, Distributing formed Controlled as a new, wholly owned State A limited liability company.
- (iii) On Date 2, Controlled formed LP as a new State A limited partnership and LLC 3 as a new State A limited liability company to act as LP's general partner. Controlled owns approximately e percent of LP, and LLC 3 owns the remainder.

Each of LP and LLC 3 is treated as a disregarded entity for federal income tax purposes.

- (iv) On Date 2, LP formed LLC 4 as a new, wholly owned State A limited liability company. LLC 4 is treated as a disregarded entity for federal income tax purposes.

### *Entity Formation*

Prior to the effective date of the Plan (the “Effective Date”):

- (v) Controlled will convert to a State B corporation.
- (vi) Controlled will form Controlled Sub as a new, wholly owned State A corporation.
- (vii) LLC 4 will form LLC 5 (a State A limited liability company) and various other LLCs (the “LP Subs”). LLC 5 and the LP Subs will be treated as disregarded entities for federal income tax purposes.

### *Corporation X Merger*

- (viii) Prior to the Effective Date, Corporation X, a State A corporation with certain shareholders in common with Parent, will merge with and into Parent, with Parent surviving. Shareholders of Corporation X will receive Parent stock in exchange for their Corporation X stock.

### *Internal Contribution and Internal Distribution*

Prior to the Effective Date:

- (ix) Distributing 2 will form Controlled 2 as a new, wholly owned State A corporation.
- (x) Distributing 2’s subsidiaries that hold “REIT Assets” (including real property associated with Business A, Structure A, and assets and personnel associated with Business B, but excluding the Retained Assets) will convert, merge, or engage in another alternative transaction under applicable state law in order to become limited liability companies (the “LLC Mechanism”).
- (xi) Distributing 2 (and its now-disregarded subsidiaries) will contribute the REIT Assets to Controlled 2 in exchange for stock therein (the “Internal Contribution”).
- (xii) Distributing 2 will distribute the Controlled 2 stock to Distributing (the “Internal Distribution”).

*Contributions and External Distribution*

- (xiii) Prior to the Effective Date, Distributing's direct and indirect subsidiaries (excluding Distributing 2, but including Controlled 2) that hold REIT Assets will convert to limited liability companies pursuant to the LLC Mechanism.

On the Effective Date:

- (xiv) Distributing (or its disregarded subsidiaries) will (i) contribute to Controlled the REIT Assets (including Structure A, the Business B assets, and all assets received as a result of the Internal Distribution), and (ii) cause the Business B employees working for LLC 2 to become Controlled Sub employees, in exchange for (a) 100 percent of Controlled common and preferred stock, (b) new debt to be issued by LLC 4, (c) the right to receive proceeds of the debt to be issued in Step (xvii), and (d) potentially, the assumption by Controlled of a portion of Distributing's liabilities related to the real property transferred and certain operating liabilities associated with Business B (collectively, the "Contribution").
- (xv) Controlled will contribute at least e percent of its interests in the REIT Assets (other than the Business B assets) to LP in exchange for at least e percent of interests therein, and Controlled will contribute its remaining interests in the REIT Assets (other than the Business B assets) to LLC 3. LLC 3 will contribute its interests in the REIT Assets to LP in exchange for no more than f percent of interests therein. LP will further contribute its interests in the REIT Assets to LLC 4. These contributions will be disregarded for federal income tax purposes.
- (xvi) LLC 4 will contribute certain assets to LLC 5. This contribution will be disregarded for federal income tax purposes.
- (xvii) LLC 5 will issue secured non-guaranteed debt (the "LLC 5 Market Debt") to third parties and distribute the proceeds to LLC 4, which will distribute the proceeds, together with LLC 4 debt, to LP, which will distribute the proceeds and the LLC 4 debt to Controlled, which will distribute the proceeds and the LLC 4 debt to Distributing. If LLC 5 cannot find third parties willing to acquire all of the LLC 5 Market Debt, it will distribute the cash proceeds of any issued debt, plus LLC 5 mezzanine debt, to LLC 4, which will distribute the cash and the debt, together with LLC 4 debt, to LP, which will distribute the cash and the debt to Controlled, which will distribute the cash and the debt to Distributing.
- (xviii) Controlled will contribute the Business B assets and liabilities to Controlled Sub as a capital contribution.
- (xix) LLC 4, LLC 5, and the LP Subs will enter into one or more long-term, triple-net



master leases with Distributing and its subsidiaries with respect to the REIT Assets (other than the Business B assets).

- (xx) Parent will contribute cash and convertible notes (the “Parent Convertible Notes”) to Distributing (the “Parent Contribution”). To the extent Distributing’s minority shareholders have not been eliminated already, this step will dilute their ownership to less than f percent.
- (xxi) In satisfaction of its liabilities, Distributing will distribute to the Creditors: common and preferred stock of Controlled; cash; new Distributing debt (or cash in lieu thereof); LLC 4 debt (or cash in lieu thereof); Distributing preferred stock; LLC 5 debt (or cash in lieu thereof); and Parent Convertible Notes (the “External Distribution”).

Certain of the foregoing types of consideration are subject to elections. For example, the receipt of LLC 4 debt or LLC 5 debt is subject to an election to receive Controlled common stock in lieu of such debt (the “LP Equity Election”). Moreover, the LP Equity Election is subject to the right of Distributing, in its sole discretion, to modify or eliminate the exercise of this election as necessary to preserve continuity of interest for purposes of section 355.

Certain Creditors also may receive LP interests instead of Controlled stock. More specifically, a Creditor will receive LP interests if and to the extent such Creditor otherwise would receive more than g percent of Controlled common or preferred stock and does not obtain certain ownership waivers. If any Creditors fall into this category, the following additional or revised Steps will occur pursuant to the Proposed Transaction:

- Prior to the Effective Date, Distributing will form LLC 6 as a new limited liability company that will be treated as a disregarded entity for federal income tax purposes.
- In Step (xiv), Distributing will not contribute all of its REIT Assets to Controlled in the Contribution. Instead, Distributing will contribute to Controlled an undivided interest in certain REIT Assets (including Structure A and all assets received as a result of the Internal Distribution) and will retain an undivided interest in other REIT Assets. Distributing then will contribute its remaining interests in the REIT Assets to LLC 6 in exchange for LLC 6 interests, new LLC 6 debt, and the right to receive a portion of the proceeds from the debt (or the debt itself) issued in Step (xvii). This contribution will be disregarded for federal income tax purposes.
- In Step (xvii), LP will distribute only a portion of the debt issuance proceeds (or the debt itself) to Controlled, which will distribute the cash (and the debt) received to Distributing. LP will distribute the remainder of the cash (and debt) to Distributing as consideration for the merger of LLC 4 and LLC 6 (the

“LLC 6 Merger”).

- In the LLC 6 Merger, LLC 6 will merge with and into LLC 4, which will survive the merger and assume the LLC 6 debt. In the LLC 6 Merger, Distributing will receive common and preferred interests in LP (which will be treated as a partnership for federal income tax purposes). Distributing then will distribute all of such LP interests to the Creditors.

### *Sales*

- (xxii) The Controlled preferred stock distributed to Creditor Group 2 in Step (xxi) will be subject to a call option held by the Backstop Parties (which may buy up to h percent of Controlled preferred stock under this option) and to a put option whereby Creditor Group 2 may sell some or all of the Controlled preferred stock to the Backstop Parties. Such sales (the “Sales”) will take place after the External Distribution, with Parent likely acting as the clearing house.

### *Distributing Merger and Parent Stock Buyback*

- (xxiii) Parent will form Distributing LLC, a limited liability company that will be disregarded as separate from Parent for federal income tax purposes.
- (xxiv) Distributing will merge with and into Distributing LLC, with Distributing LLC surviving (the “Distributing Merger”). Pursuant to the Distributing Merger, holders of Distributing preferred stock will receive Parent common stock. Under state law, the shares of Distributing common stock will be cancelled and converted into membership interests of Distributing LLC.
- (xxv) Immediately after the Distributing Merger, Parent will purchase at least \$i of Parent common stock from certain classes of Creditor Group 3 that receive Parent common stock in connection with the Distributing Merger, provided that if Distributing determines in good faith that such repurchases would cause Distributing to fail to satisfy the continuity of interest requirement of section 355, Distributing may, with the consent of certain members of Creditor Group 3, modify such repurchases to the extent necessary to eliminate such failure. In addition, Distributing may, in its sole discretion, if it determines that doing so would not cause the External Distribution to fail to satisfy the continuity of interest requirement of section 355, repurchase up to an additional \$j of Parent common stock from certain members of Creditor Group 2 and Creditor Group 3 that receive Parent common stock in connection with the Distributing Merger (such initial and additional repurchases, the “Parent Stock Buyback”). Following the Sales, the Distributing Merger, and the Parent Stock Buyback, Creditors will hold approximately k percent (more than 50 percent) of the value of Parent’s common stock.

*REIT Election and Distributions*

- (xxvi) For the year of the foregoing transactions or for the following year, Controlled will elect to become a real estate investment trust ("REIT") within the meaning of section 856(a), and Controlled Sub will elect to be treated as a taxable REIT subsidiary within the meaning of section 856(l). Controlled may fail to qualify as a publicly offered REIT within the meaning of section 562(c)(2).
- (xxvii) Before the end of its first REIT taxable year, Controlled will make one or more "purging distributions" to its shareholders with respect to its stock as required by section 857(a)(2)(B) in an amount intended to eliminate all of its accumulated undistributed C corporation earnings and profits ("E&P"). Controlled also will pay dividends to its shareholders in an amount equal to its REIT taxable income. To conserve cash flow, Controlled expects all of these distributions in its first three REIT taxable years to include a combination of stock and cash (collectively, the "Cash/Stock Distributions").

Pursuant to the declaration of each Cash/Stock Distribution (and irrespective of any other options the shareholders may be offered regarding the Cash/Stock Distribution), each shareholder may elect to receive its entire entitlement under the declaration in either cash or stock of Controlled of equivalent value, subject to a cap on the amount of cash to be distributed to all shareholders (the "Cash Limitation"). The Cash Limitation will be no less than 1 percent of each aggregate declared Cash/Stock Distribution.

If the Cash Limitation on any distribution is exceeded, then persons requesting cash will receive a portion of their distribution in stock. More specifically, each shareholder electing to receive its entitlement in cash will receive a pro rata amount of cash corresponding to the shareholder's entitlement under the declaration, but in no event will any shareholder electing to receive its entitlement in cash receive less than 1 percent of the shareholder's entire entitlement under the declaration in cash. If the Cash Limitation on any distribution is not reached, then persons requesting equity will receive a portion of their distribution in cash, and persons requesting cash will receive their entire entitlement in cash.

The calculation of the number of shares to be received by any shareholder will be determined, over a period of no more than two weeks ending as close as practicable to the payment date, based upon a formula that utilizes market prices and is designed to equate in value the number of shares to be received with the amount of cash that could be received instead. This formula will also be used to determine the value of shares to be distributed and to determine the amount of the Cash Limitation.

With respect to any shareholder participating in a dividend reinvestment plan (“DRIP”), the DRIP applies only to the extent that, in the absence of the DRIP, the shareholder would have received the distribution in cash.

Following the Proposed Transaction, Distributing LLC will own the Business A assets (including the Retained Assets) other than the assets contributed to Controlled (or LLC 6). In turn, the Creditors will wholly own Controlled, which will own (directly or indirectly) the bulk of the Business A real property and all of the Business B assets. As described in Step (xix), LLC 4, LLC 5, and the LP Subs will lease the transferred Business A real property back to Distributing LLC and its subsidiaries, which will continue to operate Business A.

For purposes of the Internal Distribution, Distributing 2 will rely on Business A1 to satisfy the active trade or business requirement in section 355(b), and Controlled 2 will rely on Business B1. At the time of the Internal Distribution, the estimated fair market value of the Business A1 real property transferred to Controlled 2 will be about \$m, and the estimated fair market value of the Business B1 assets will be about \$n.

For purposes of the External Distribution, Distributing will rely on Business A to satisfy the active trade or business requirement in section 355(b), and Controlled will rely on Business B. At the time of the Contribution, the estimated fair market value of the Business A real property transferred to Controlled will be about \$o, and the estimated fair market value of the Business B assets will be approximately \$p.

Additionally, Controlled may make loans to Controlled Sub that will be secured by mortgages or deeds of trust on “interests in real property” of Controlled Sub.

Furthermore, Parent or Controlled intends to file Form(s) 3115, Application for Change in Accounting Method, to change its method of depreciating Structure B to methods that are consistent with the taxpayer’s characterization of Structure B as real property or interests in real property for purposes of section 856. These method changes will generate positive taxable section 481(a) adjustments that will be includable in Controlled’s taxable income.

## REPRESENTATIONS

The taxpayer has made the following representations with respect to the Proposed Transaction:

- a) Distributing is currently under the jurisdiction of the Bankruptcy Court in a title 11 or similar case (within the meaning of section 368(a)(3)(A)) and will be under the jurisdiction of the Bankruptcy Court in a title 11 or similar case (within the meaning of section 368(a)(3)(A)) at the time of the Proposed Transaction.

- b) The Proposed Transaction will occur pursuant to the Plan and will be confirmed by the Bankruptcy Court as part of the Bankruptcy Proceeding.

### RULINGS

Based on the information provided and the representations set forth above, we rule as follows:

- (1) The transfer of the employees and managers of Business B in Month 2, Year 1 to LLC 2 will not prevent Controlled 2 or Controlled from satisfying the active trade or business requirement of section 355(b) with respect to the Internal Distribution or the External Distribution.
- (2) The relative fair market value of the gross assets of Business B1 as compared to the fair market value of all gross assets of Controlled 2 will not prevent Controlled 2 from satisfying the active trade or business requirement of section 355(b) with respect to the Internal Distribution.
- (3) The relative fair market value of the gross assets of Business B as compared to the fair market value of all gross assets of Controlled will not prevent Controlled from satisfying the active trade or business requirement of section 355(b) with respect to the External Distribution.
- (4) Provided that the Distributing Merger qualifies under section 332 or section 368(a), the Creditors will be treated as owning proprietary interests in Distributing (determined pursuant to the methodology set forth in §1.368-1(e)(6)) for purposes of the continuity-of-interest requirement in § 1.355-2(c). The External Distribution will satisfy this continuity-of-interest requirement provided that, immediately after the Sales, the Distributing Merger, and the Parent Stock Buyback, persons who were creditors of Distributing immediately before the External Distribution hold Controlled stock, Distributing stock, or Parent stock issued in exchange for Distributing stock in connection with the Distributing Merger that collectively comprises at least 40 percent of the value of all consideration distributed in the External Distribution with respect to proprietary interests in Distributing.
- (5) The External Distribution will satisfy the distribution-of-control requirement of section 355(a)(1)(D).
- (6) After accounting for the Distributing Merger, the Parent Contribution will not cause the Internal Distribution or the External Distribution to be a “disqualified distribution” within the meaning of section 355(d).
- (7) Distributing’s E&P, if any, will be allocated between Distributing and Controlled in

accordance with section 312(h) and § 1.312-10(a). Parent's E&P, if any, will be reduced by the amount of E&P allocated to Controlled. Sections 1.1502-33(b)(1), 1.1502-33(e)(3), and 1.1502-80(a)(2).

- (8) The basis limitation in section 361(b)(3) will not apply to the External Distribution.
- (9) The cash and stock distributed in the Cash/Stock Distributions shall be treated as a distribution of property with respect to stock to which section 301 of the Code applies. Sections 301 and 305(b)(1). The amount of the distribution of the stock received by any holder of Controlled stock electing to receive or otherwise receiving stock in a Cash/Stock Distribution will be considered to equal the amount of money that could have been received instead. Section 1.305-1(b)(2). If a shareholder receives stock that has a fair market value on the distribution date that differs from the amount of cash the shareholder could have received instead, such difference will not cause the Cash/Stock Distribution to be a preferential dividend under section 562(c) because, pursuant to § 1.305-1(b)(2), the amount of the distribution is equal to the amount of cash that could have been received instead.
- (10) A loan by Controlled to Controlled Sub secured by "interests in real property" of Controlled Sub will be treated as a "real estate asset" and will not be treated as a "security" under section 856(c)(4)(B)(ii).
- (11) Pursuant to section 856(c)(5)(J)(i), positive section 481(a) adjustments will not be taken into account in determining whether Controlled satisfies the gross income tests of section 856(c)(2) and (3).
- (12) The correlative E&P adjustments with respect to a section 481(a) adjustment will be made over the same period as the section 481(a) adjustment. To the extent the positive section 481(a) adjustments exceed the correlative E&P adjustments arising from the change in computing depreciation, any distributions of such excess (that are distributed and treated as dividends by Controlled) will be treated as made from E&P.

#### CAVEATS

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, no opinion is expressed or implied on whether Controlled will otherwise qualify as a REIT under subchapter M of the Code. Further, no opinion is expressed as to whether Structure B is real property or interests in real property for purposes of section 856. We further express no opinion on: (a) the propriety of the amount of any net section 481(a) adjustment; (b) the propriety of the taxpayer's proposed method of depreciating Structure B under section 168; (c) whether

Structure B is section 1245 property or section 1250 property for depreciation purposes; (d) whether Structure B constitutes real property for depreciation purposes; or (e) the consequences of Controlled's proposed REIT election on the section 481(a) adjustment period or the E&P adjustments at the time of the REIT election.

#### PROCEDURAL STATEMENTS

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representatives.

Sincerely,

Russell G. Jones  
Senior Counsel, Branch 3  
Office of Associate Chief Counsel (Corporate)